PROPOSED AMENDMENTS TO THE FEDERAL BANKRUPTCY LAW.

Tested by practical operation for more than three years in every section of the country and among all sorts and condition of men, the Federal Bankruptcy Law of 1898, to secure the benefits of which the people labored patiently for twenty years, has proved a source of genuine satisfaction to its friends and bitter disappointment to its enemies. Many gloomy prognostications remain unfulfilled. It has not created a debtor's paradise, although it has freed from slavery thousands of unfortunate men; nor, on the other hand, has it been an instrument of oppression in the hands of rapacious and unreasonable creditors, although it has strengthened credit—the soul of commerce—by affording creditors protection against their less scrupulous competitors. Credit is given more freely than heretofore except in that particular class of cases where it is extended in consideration of a preference.

During the year ending September 30, 1901, there were filed 17,015 voluntary petitions. In 13,688 cases closed during the year the total liabilities amounted to $162,635-658, while the net assets realized for distribution as dividends were $3,587,447. The various occupations were represented as follows: 1,459 farmers, 7,068 wage-earners, 2,852 merchants, 248 manufacturers, 415 professional men and 1,645 contractors, hotel and saloon-keepers, real estate men and others. During the same period 1,992 petitions were filed by creditors in involuntary cases. In 786 of these cases closed during the year, the liabilities amounted to $11,316,689, while the total assets scheduled were $2,534,-266. Those against whom petitions were filed were apportioned among the different occupations as follows: 96 wage-earners, 463 merchants, 56 manufacturers, 10 professional men, 5 farmers and 157 of a miscellaneous character. The farmers and wage-earners must have been engaged in other occupations as well to make them subject to the invol-

untary features of the act. A large proportion of the involuntary petitions filed represent insolvent cases that have been accumulating during the period since the repeal of the last Federal Bankruptcy Law in 1878. The number of involuntary cases, while relatively small, is large enough to demonstrate that the advantages of the act have been appreciated by merchants and other business men, and that it has become thoroughly incorporated in our system of commercial law. In three successive conventions the National Association of Credit Men have adopted resolutions expressing their approval of the law in its general features.

The warmest advocates of the Henderson bill—the compromise measure enacted into law in 1898—never claimed for it perfection; and, as was anticipated, experience has revealed defects. Amendments, however, should be made slowly and cautiously lest the complex industrial interests affected may receive an undue shock and the existence of the law itself be jeopardized.

The bill now pending in Congress known as the Ray bill and introduced by the Hon. George W. Ray, Chairman of the Judiciary Committee of the House of Representatives, proposes several amendments, two of which touching preferences have been occasioned by recent decisions of the Supreme Court of the United States.

One of the cardinal principles underlying bankruptcy legislation is to secure an equitable distribution of the bankrupt's assets among his creditors. This was the original purpose of such laws, is common to every known system, and antedates by centuries the idea of a debtor's discharge from the unpaid residue of his debts, which had its origin in England during the reign of Queen Anne.

At common law a debtor on the verge of insolvency may not only dispose of his property for the benefit of all his creditors, but may, by the conveyance, give a preference to one creditor over another, or to one class of creditors over another class. This rule has been followed in England, the United States Supreme Court and some of the States of the Union—for instance, New York. The preference may be made by the payment of money or the transfer of property. Among the States in which preferences are not forbidden

by statute are New York, Ohio, Indiana, Virginia, Florida. Georgia, Mississippi, Montana, Nevada, New Mexico, North Carolina, Texas, Utah, and also the District of Columbia.

Much of the prevailing satisfaction with the Bankruptcy Act is due to its success in preventing fraudulent preferences, and bringing order and certainty out of the chaos caused by the diverse State laws. It has given a definition of a preference in Section 60, subdivision *a*, and then has given a remedy in subdivision *b* of the same Section, as follows:

Section 60, *a*. PREFERRED CREDITORS.—A person shall be deemed to have given a preference if, being insolvent or in contemplation of insolvency or bankruptcy, he has procured or suffered a judgment to be entered against himself in favor of any person, or made a transfer of any of his property with intent to (1) defeat the operation of this act; or (2) enable any one of his creditors to obtain a greater percentage of his debt than any other of such creditors of the same class.

b. If a bankrupt shall have given a preference within four months before the filing of a petition, and the person receiving it, or to be benefited thereby or his agent acting therein, shall have had reasonable cause to believe that it was intended thereby to give a preference it shall be voidable by the trustee, and he may recover the property or its value from such person.

It will be noticed that Section 60, subdivision *a*, defining a preference, does not say that the person receiving the so-called preference must have had reasonable cause to believe that a preference was intended thereby, although that condition must exist before the property or its value may be recovered by the trustee under subdivision *b*.

Section 57, subdivision *g*, provides that the claims of creditors who have received preferences shall not be allowed unless such creditors shall surrender their preferences.

In the recent case of Carson, Pirie, Scott & Company *v.* The Chicago Title and Trust Company,[1] the Supreme Court of the United States has construed the foregoing sections to mean that payments by an insolvent debtor on account and in the ordinary course of business, though made and received innocently, the debtor not intending to give a preference and the creditor not knowing or having reason to believe that the bankrupt is insolvent at the time of the payment, are nevertheless preferences within the meaning of subdivision *a* of Section 60 and must be sur-

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[1]182 U. S. 438.

rendered pursuant to subdivision *g* of Section 57, if the creditor so paid desires to participate *pro rata* in the distribution of the bankrupt's estate. The so-called preference which has been received innocently by a creditor may be retained by him if he so elects, but he will not be permitted to prove the balance of his claim in the bankruptcy case.

Inasmuch as the court's decision is based upon the meaning to be derived from the language of the statute, we are not precluded thereby from considering the question on its merits and inquiring whether this is not an instance where the law should be amended.

As it now stands, a creditor who in good faith receives a partial payment of his claim from an insolvent debtor, that is to say, one whose assets at a fair valuation are less than his liabilities, must surrender what he has received or lose the balance of his claim; while the creditor who has exacted the entire amount of his claim may retain the whole, presumably as a reward for his superior agility or brutality as the case may be. It has been urged that this is not unjust discrimination between creditors of the same class such as it is the aim of bankruptcy legislation to prevent, because one who has been paid in full has ceased to be a creditor and is no longer amenable to the provisions of the Bankruptcy Act; but may it not with equal propriety be said that one who has been paid in part has ceased to be a creditor for the portion of his claim for which he has received satisfaction and appears before the referee in bankruptcy as a creditor for the balance only?

Furthermore, subdivision *a* of Section 60 in defining a preference fixes no specific time limit, so it is probable that any payment received during the debtor's insolvency, whether four months or four years before an adjudication of bankruptcy, would be included within the purview of subdivision *g* of Section 57, and indeed the United States District Court of Massachusetts has already held that a creditor, as a condition precedent to the proof of his claim, must surrender all preferences received while the bankrupt was insolvent, although made more than four months prior to the filing of the petition and whether the creditor had knowledge of the intent to prefer or not.

A creditor, then, who accepts a payment on account, un-

less he wishes the remainder of his claim confiscated, may not consider the money absolutely his own, but must lay it aside as a trust-fund to be returned on demand in case at some time in the future his debtor may be adjudged a bankrupt and his schedules show that at the date of the payment mentioned his assets were less than his liabilities. This would seem to be a hardship to creditors because of the uncertainty it introduces into business transactions, and also to debtors since a refusal on the part of a cautious creditor to accept a partial payment may injure the credit of even a solvent debtor and perhaps cause his failure. Unless confident of their ability to extract the last drop of blood, prudent men will hesitate to give credit.

The doctrine has been carried even further by some courts, which have held that when the act provided that creditors who have received preferences shall not have their claims allowed until the preferences have been surrendered, it meant by "claims" the entire amount due upon all accounts from the bankrupt to the creditor, whether separate or distinct transactions or not. For instance: If a creditor holds three notes, one of which has been paid in full, he may not prove his claims on the other two without surrendering the payment received on the first.

The decisions in these cases are based on the language of the present act, which is broader than that of the Law of 1867. By the latter act, it was the "debt or claim on account of which the preference was made" which could not be proved, while the Law of 1898 forbids the proof of "claims of creditors who have received preferences."

Other cases hold that transactions, which as separate causes of action should be separately stated in a complaint, may be considered separate and distinct bases of a claim in bankruptcy, one of which may be disallowed or withheld if a preference has been received upon it and the others proved and allowed without a surrender of a preference received on a distinct transaction. The net result of the cases is to increase the delightful uncertainty in the minds of the business community.

Some light may be shed upon the subject of preferences by a study of the laws of the commercial nations of Europe. The Romans elaborated a body of principles of equity juris-

prudence that has challenged the admiration of subsequent ages. It may then be both interesting and profitable to consider their treatment of the matter in question.

For fraudulent alienations and acquittances they provided the *actio Pauliana* which has survived in some of the modern codes.[1] We find in the Institutes of Justinian that if a man has delivered anything to a third person in fraud of creditors, the latter, after they have obtained possession of his goods under a decree of the president of the province, are allowed to rescind the delivery and to demand the thing, that is, to allege that the thing has not been delivered, and, therefore, has remained among the debtor's goods.[2] An alienation in fraud of creditors comprehended any act or forbearance by which a debtor diminished the amount of his property divisible among his creditors, but not a forbearance by which a debtor merely failed to add to his property.[3] The mere payment of a debt was not a subtraction from the assets of the debtor within the meaning of the edict, unless the object of the payment was to give a fraudulent preference to one of the creditors.[4] The Roman maxim was: "*Nihil dolo creditor facit qui suum recepit.*"[5] It was also necessary that the alienation should have been made with the intention of diminishing the assets available for the creditors.[6] The intention was presumed to exist when the debtor knew himself to be insolvent, or knew that the alienation would render him insolvent.[7] If the alienation was made without valuable consideration, it was rescinded even though the person in whose favor it was made was innocent of the fraud; but if it was for valuable consideration, it would stand unless the third party knew it was in fraud of the creditors.[8]

From the foregoing synopsis, it may be gathered that the Roman jurists did not regard as a preference a payment made in the ordinary course of business where there was no guilty intent on the part of either debtor or creditor.

The Italian cities of the middle ages established what is known as the "suspicious period," that is to say, a period preceding bankruptcy, of which the duration varied in the

[1] Digest, 42, 8; Code Civil des Français, Art. 1167. [2] Institutes, 4, 6, 6.
[3] Digest, 50, 17, 134, pr. [4] Digest, 42, 8, 6, 7; 42, 8, 24; 42, 5, 6, 2.
[5] Digest, 50, 17, 129. [6] Digest, 50, 17, 79; and 42, 8, 1, pr, and 10, pr.
[7] Digest, 42, 8, 17, 1. [8] Digest, 42, 8, 6. 17, 1.

different cities from two days to a month. During this time, the acts of the debtor were deemed fraudulent, and it was unnecessary for the party seeking to annul them to prove an intention to injure the creditors.

The modern European bankrupt laws have generally preserved this "suspicious period" in one form or another; but they have applied the equitable principles of the Roman law in determining what acts done during that period are valid. Speaking generally, we may say that the acts which may be annulled in the interest of the estate are those done in bad faith, although for a valuable consideration; those done for no valuable consideration, although in a few cases the presumption of bad faith raised against gratuitous acts is allowed to be rebutted; and finally those of an equivocal character that are presumed to have been done to favor certain creditors to the prejudice of others, such as the payment of a debt before it is due, or in an unusual manner, or the granting of a security for a debt previously contracted.

By the French and the Belgian laws, payment of debts that have fallen due and in general all acts for a valuable consideration performed in the interval between the stoppage of payments and the adjudication of bankruptcy may be annulled, provided, however, that they have taken place with a knowledge on the part of the third party of the stoppage of payments. In the Netherlands, a transaction for a valuable consideration may be annulled only when it is proved that *both* parties intended to defraud creditors. Payments made when the debtor alone knew of his insolvency are valid by the German and the Austrian laws. The Italian Code of 1882 renders null payments made in the interval between the stoppage of payments and the adjudication of bankruptcy, only provided the third party knew at the time the condition of the debtor's affairs.

The English law is aimed against all voluntary conveyances and preferences given to one creditor over the others, but it seeks to protect *bona fide* transactions without notice. Payments made with a view to give a creditor a preference are deemed fraudulent and void, if bankruptcy result from a petition presented within three months of the date of the transaction, but a payment by the bankrupt to any of his

creditors, is valid if it occur before the date of the "receiving order," and the third party have no notice of any available act of bankruptcy previously committed.

The Danish law enumerates the acts which it regards as preferences, that is to say, which favor one creditor at the expense of others. Among these are abnormal payment, that is, otherwise than in money or commercial paper; normal payment of a debt not yet due; the giving of security for debts previously contracted; executions levied by virtue of an agreement between the debtor and creditor; judgments obtained in suits brought within the suspicious period, and judgments obtained through concessions in procedure made by the debtor within the suspicious period. We seek in vain among them, however, for payments made and received in good faith on account of debts already matured.

Returning to the United States, we find that under the Act of 1867 the acceptance of a payment by a creditor was not a preference unless he had reasonable cause to believe and, under the Amendment of 1874, actual knowledge that the debtor intended thereby to prefer him.

But, independently of legal or statutory definition, the term "preference" has a well-understood meaning among business men. It is the way a failing debtor with full knowledge of his condition carries out his deliberate intention of giving to one creditor a larger proportion of his estate than will be received by his other creditors in the event of his being adjudged a bankrupt, this knowledge and intent being shared by the favored creditor who co-operates with him in effecting the desired result. The transaction is not such as occurs in the ordinary course of business; but is accompanied by certain extraordinary circumstances readily detected by those conversant with such matters. It is such preferences, recognized by the common law and by many of our State statutes, that bankruptcy legislation at all times and in all climes has sought to prevent, and, as we have already said, it is the success of the remedy furnished by subdivision *b* of Section 60 in accomplishing this purpose that has commended the Bankruptcy Act of 1898 to the judgment and sound sense of the commercial world.

The Ray bill proposes an amendment to the present law which will bring it into line with prior legislation in this country and restore it to what was perhaps the original intention of its framers. To the term preference is given a meaning consonant with commercial usage, and with the equitable principles evolved by the Roman jurists and preserved through the centuries by the European codes. It provides that subdivision *g* of Section 57 be amended so as to read as follows: That claims of creditors who have received preferences voidable under Section 60, subdivision *b*, shall not be allowed unless such creditors shall surrender such preferences. In other words, a creditor who has received partial payments on account from his debtor in the ordinary course of business may retain them and prove the balance of his claim against the latter's estate unless such payments were received within four months before the filing of a petition and the creditor had reasonable cause to believe that a preference was thereby intended to be given. What is "ordinary course of business" would be determined by the referee in accordance with the character of the transaction and local custom. Ordinary course of business in a rural district might be extraordinary in a city, and *vice versa*.

Among the various provisions of the Act of 1898, there is one that was intended for the greater convenience and economy of the parties and witnesses, but has, nevertheless, given much dissatisfaction owing to the delays in the administration of bankrupts' estates occasioned thereby. The Bankruptcy Acts of 1841 and 1867 each contained a provision conferring on the Circuit and District Courts of the United States jurisdiction, concurrent with that of the State courts, over suits at law or in equity between the assignee in bankruptcy and an adverse claimant of property of the bankrupt. In framing the Act of 1898, Congress omitted any similar provision and substituted the restrictive provisions of subdivision *b* of Section 23, namely, that suits by the trustee shall only be brought in the courts where the bankrupt, whose estate is being administered by such trustee, might have brought them if proceedings in bankruptcy had not been instituted, unless by consent of the proposed defendant. The United States Supreme Court, in the case of

Bardes *v.* The First National Bank of Hawarden,[1] has interpreted this section to mean that the United States District Courts have no jurisdiction over suits by a trustee to set aside transfers of property to third parties alleged to be fraudulent as against creditors, including payments in money or property to preferred creditors, except by the consent of the proposed defendant. The Federal courts have, of course, exclusive jurisdiction over all matters and proceedings in bankruptcy, as distinguished from independent suits at law or in equity, but unless there is a sufficient jurisdictional amount and the requisite diversity of citizenship to bring the case within the jurisdiction of the Circuit Court of the United States, the trustee in bankruptcy may institute such suits only in the State tribunal.

The surcharged condition of the calendars of the State courts in many parts of the country has caused such delays that in many cases from two to five years will be consumed in the administration of estates. In the interest of a speedier settlement of bankrupts' estates, the Ray bill would amend the present law by conferring upon the United States District Courts jurisdiction concurrent with that of the State courts over suits by the trustee to set aside fraudulent transfers and preferences.

It would seem that the administration of a uniform Federal bankrupt law should be capable of complete enforcement in the Federal courts, and, as a practical matter, a law to be uniformly administered must be administered by a single system of courts having a single court of highest resort to interpret it in the last instance. A law interpreted and enforced by forty-five different systems of courts will soon cease to be uniform.

The above mentioned are but two of the problems to which the attention of Congress will soon be directed, and upon the wise solution of which may depend the future of the Federal Bankruptcy Law. When inventive genius is bringing the people of the United States into closer touch with other nations than ever before, and our rapidly expanding commerce is bearing its message of peace to all parts of the civilized world, we should not, by a repeal of the Bankruptcy Act, relapse into our former barbaric state

[1] 178 U. S. 524.

of narrow, selfish and conflicting systems; but should rather give our best thought to securing, for all the nations of the earth engaged in international commerce, uniform bankruptcy laws, based on justice, mercy and common sense, ever looking forward to the reign of universal law in the future, perhaps not so far distant, when

> "The war-drum throbs no longer, and the battle flags are furl'd
> In the Parliament of man, the Federation of the world."

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